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IN REPLY REFER TO

PAS 730.3.B.2

February 15, 2005
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MEMORANDUM FOR REGIONAL DIRECTORS, DCAA
DIRECTOR, FIELD DETACHMENT, DCAA

SUBJECT: Audit Guidance on Retention and Filing of Working Papers

This memorandum provides new audit guidance on the retention of current, superseded, and extraneous working papers.

A. Background/Relevant References

1. Background. The guidance in CAM 4-400, Audit Working Papers, specifically on the retention and filing of audit working papers, has been interpreted in different ways. The ability to electronically create, alter, supersede, and retain working papers contributes to the creation of unnecessarily large files. Large files negatively impact the ability to transmit and store audit working paper files and increase the number of hours spent on processing and reviewing extraneous working papers.

Generally Accepted Government Auditing Standards (GAGAS), *Attest Documentation* (paragraphs 6.22 – 6.26) and *Relationship between GAGAS and Other Professional Standards* (paragraphs 1.09 and 1.10) are the authoritative sources for DCAA auditors regarding audit working paper documentation. However, GAGAS provides for use of other sources as long as there is no conflict with the Yellow Book. Recently other standard setting bodies have issued standards related to audit documentation which expand on some concepts which are of benefit to DCAA. Therefore, we are issuing expanded guidance to DCAA auditors to assist in the interpretation and clarification of GAGAS audit documentation standards.

2. CAM Guidance. The current CAM guidance on extraneous and superseded working papers is in sections 4-402d and 4-402e(2), which are summarized below.

4-402d – Working papers should be relevant to the audit assignment. Files should not include extraneous pages. Superseded working papers should be clearly marked as such and retained.

4-402e(2) – The working papers must support the final audit opinion. Any working papers that support an incorrect or inappropriate opinion that differs from the final audit report should be superseded.

The CAM does not specifically define extraneous and superseded working papers and, consequently, DCAA auditors frequently misclassify extraneous working papers as superseded and/or do not sufficiently document superseded working papers.

B. New Audit Guidance

Effective immediately, the treatments of current, superseded, and extraneous working papers and definitions of such are as follows:

1. Current working papers. Current working papers should be relevant to the audit assignment and support the report conclusions. GAGAS field work standards on audit documentation require that working papers be appropriately detailed and organized to provide a clear link to the findings, conclusions, and recommendations contained in the report. When a revision in audit scope occurs, the working papers that document the audit field work and conclusions based on the revised scope are classified as current working papers because they are relevant to the reported audit conclusion. An increase or decrease in audit scope should be adequately documented as part of the “revised scope” working papers. If the revision in the audit scope is significantly different from the working paper B risk assessment, the auditor should also make a notation in this section as well. The documentation, in all cases, should briefly describe the original audit scope and the reason for the revision in scope. Scope revisions may result from, but are not limited to, the following:

- The performance of audit procedures that indicate a need for significant modification of planned audit scope,
- Issuance of an audit report (e.g., an ICAPS report) that results in a significant change in the assessed level of audit risk for a particular audit area, and/or
- An increase or decrease in audit scope based upon revised customer needs.

2. Superseded working papers. Superseded working papers should only include unreconciled differences of opinion that are significant to the subject matter or assertion under audit. Significant differences of opinion are differences that materially change questioned costs or will change the report conclusion from unqualified to qualified or adverse. Differences in relevant and significant conclusions that are not reconciled should be elevated to the next highest level of management. Every effort should be made to reconcile all differences of opinion before report issuance. Superseded working papers should be marked as superseded, and adequately documented to ensure that the facts and circumstances are ascertainable at a later date. The relevant records to be retained include, but are not limited to, procedures performed in response to the information and records; accounting and auditing facts that support the final audit conclusions reported; and documentation on consultations on differences in professional judgment between the auditor and supervisory auditor and/or among other DCAA management. Superseded working papers should be retained in a superseded folder in the APPS working paper file.

SUBJECT: Audit Guidance on Retention and Filing of Working Papers

3. Extraneous working papers. Extraneous working papers that are not on subject and not relevant to the audit conclusions should be removed from the audit file. Extraneous working papers include the following:

- Working papers associated with reconciled differences in opinion,*
- Inaccurate working papers that are based on incomplete information or preliminary data. (false starts),
- Working papers that are re-formatted but contain the same information as working papers included in the current file,
- Working papers that were later edited to correct mathematical errors, spelling, or grammar, and
- Working papers that are changed due to revisions in audit methodology driven by auditor judgment that are not relevant to the audit conclusion.

** Frequently, differences of opinion initially result from incomplete or preliminary thinking or entry level auditor errors. These are usually easily reconciled. Generally, the auditing standards on documentation do not require auditors to retain documentation of these reconciled differences of opinion.*

In certain situations (i.e., contractor errors and/or significant hours incurred), the auditor or supervisor may determine that it is necessary to document the deletion of the extraneous working papers. In this case, the auditor and supervisor should discuss the issue, and if necessary, document the reason for the generation of the extraneous working papers, including the estimated hours incurred. Documentation should be brief and to the point. Extraneous working papers should not be retained in the current working paper file. The need to retain extraneous working papers in a separate file, for the purpose of supporting auditor performance or contractor issues, is a discretionary supervisor and/or management decision.

To assist in the application of the new guidance, we have included examples of current, superseded, and extraneous working papers as an Enclosure to this memorandum.

Offices may address their questions to Ms. Deaune Volk, Program Manager, Auditing Standards Division (PAS), at (703) 767-3233 or e-mail address, dcaa-pas@dcaa.mil.

/Signed/
Robert DiMucci
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Enclosure
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Examples of Current, Superseded, and Extraneous Working Papers

Examples of current working papers that must be retained in the file:

- Documentation of the basis for the auditor's reported conclusions.
- Conclusions that are not contained in the audit report - The auditor prepares a working paper on a significant cost element that discloses immaterial questioned cost that is not reported, or audit procedures disclose an immaterial (technical) CAS non-compliance.
- Revision in scope - The preliminary audit risk assessment of a cost proposal determines that proposed Other Direct Costs (ODCs) are low risk. In the process of examining only the high dollar ODC items, the auditor identifies significant questioned costs. Based on the results of the audit procedures performed, the audit scope is expanded. Working papers that represent the revised audit scope should include a statement about the previous audit scope and reasons why the scope was increased. For example, "On (date) we applied judgmental sampling techniques to the proposed ODCs. The results of the judgmental sample disclosed significant questioned costs. We consider the risk of misstatement of ODCs to be increased. Therefore we are applying statistical sampling to the entire ODC universe. Approximately 8 hours was incurred on the judgmental sampling working papers." Since the ODCs were identified as low risk on working paper B, the auditor should also make a notation on working paper B, and reference the revised audit scope working papers.

Examples of superseded working papers:

- An examination of the contractor's billing system discloses that the system does not adequately exclude unallowable costs. It is the auditor's professional judgment that the contractor's billing system is inadequate in part. Because of the materiality of the impact of the deficiency, the report opinion is revised to inadequate (adverse). The auditor and supervisor disagree on the revised adverse report opinion. The disagreement between the auditor and supervisor is not reconciled. An explanation of the resolution of the difference in opinion is retained as a superseded working paper (e.g., the auditor's original conclusion and a management decision).
- In an incurred cost audit, the auditor questions \$100,000 of travel and lodging costs for attendance at a defense contractor convention. The costs are questioned under FAR 31.205-14, Entertainment costs. The supervisor disagrees with the auditor's opinion and determines that the costs are allowable under 31.205-43 Trade, business, technical and professional activity costs. The difference in opinion is not reconciled. An explanation of the resolution of the difference in opinion is retained as a superseded working paper (e.g., the auditor's original conclusion and a management decision).

Examples of extraneous working papers:

- Original working papers that were later re-formatted or edited to correct math errors or spelling.

- Reconciled differences of opinion - An examination of the contractor's billing system discloses that the system does not adequately exclude unallowable costs. It is the auditor's professional judgment that the contractor's billing system is inadequate in part. Because of the materiality of the deficiency, the report opinion is revised to inadequate (adverse). The auditor and supervisor agree on the revised adverse report opinion. The working papers documenting the initial opinion are considered extraneous and should be removed from the file or electronically revised to reflect the reported opinion.
- Working papers that are not on subject - The auditor applies transaction testing to an incorrect data base which was provided by the contractor. The auditor should discuss with his or her supervisor, and appropriately document the error and the estimated hours incurred. The working papers are considered extraneous and should be removed from the file. Likewise, if the auditor is responsible for taking the "wrong road" (e.g., computes audit determined rates by applying incorrect information), the auditor should discuss with the supervisor, and appropriately document the error and the hours incurred. The supervisor can document the situation on W/P A-2, Interim Guidance and/or A-3 Final Review Notes, if he or she considers it appropriate. Retaining the incorrect working papers in the employee's personnel file is a supervisory decision (for future performance-related actions).
- Change in audit methods - The auditor chooses to use judgmental sampling because statistical sampling is not time and/or cost effective. The auditor later decides to try out a new statistical sampling method that was presented at a FAO staff meeting. The original audit sampling plan and resulting questioned costs are based on a false start and should be considered extraneous and removed from the file.